

Supreme Court, U. S.

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IN THE

Supreme Court of the United States

October Term, 1977

No. 77-587

JEANNE HARR and L. J. HARR for and on behalf of
themselves and all others similarly situated,

Petitioners,

v.

PRUDENTIAL FEDERAL SAVINGS
AND LOAN ASSOCIATION,

Respondent.

L. J. HARR, JEANNE HARR, LAWRENCE J.
ECHOHAWK, ED FULTON, DIANE FULTON, DON
HUTCHISON, C. GERALD PARKER, DONALD
DREW, CARRIE DREW, AND DOUGLAS McGREGOR,

Petitioners,

v.

FEDERAL HOME LOAN BANK BOARD
an agency of the United States,

Respondent.

PETITIONERS' REPLY TO THE RESPECTIVE
BRIEFS IN OPPOSITION TO THE PETITION
FOR CERTIORARI

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Petitioners reply to the respective answering briefs
to correct mischaracterizations made in those documents
and to demonstrate why, in light of the respondent's ar-
guments, certiorari is appropriate here.

ARGUMENT

Neither the Government nor Prudential address the real issue which merits review, which is whether the courts below erred in ruling that investors in savings and loans called upon to cast their votes on a proposition of management are *not* entitled to the same high standards of disclosure that Congress and this Court have carefully secured to other investors. In lieu of addressing that crucial issue, both respondents raise two obfuscating and fallacious arguments.

A. The complaint does not amount to an attack on the Board's order.

Both respondents incorrectly state that the complaint in *Prudential* was one challenging the Bank Board order permitting the conversion. They would thus avoid the otherwise direct conflict between the decisions below and both Congress' clearly expressed intention in enacting Section 12(i) of the 1934 Act and this Court's decisions in *Borak* and *Mills*.

This argument fails, because it incorrectly characterizes the complaint which the Court of Appeals correctly summarized at A-4:

The allegations were that a plan to convert to a stock association was a part of conspiracy by the directors to benefit themselves and the officers; that the plan was unfair and itself deceptive; *that the proxy material was deceptive*; and that Rule 10b-5... was violated. (emphasis added)

Thus the complaint clearly asserted the inadequacy of the proxy materials under the *Borak - Mills* line of cases.

The respondents attempt to avoid this fact by arguing that the courts below made "factual" determinations

that the *Prudential* complaint in reality was a challenge to the fairness of the plan also must be rejected. The *Prudential* complaint was dismissed by the district court without an answer being filed and without any evidence being taken. The courts below thus could have found no "facts" to change the allegations of the complaint and, under well settled authority, the allegations of the complaint must be taken as true and construed in a manner most favorable to the plaintiffs.

The *Prudential* complaint did contain allegations regarding the fairness of the transaction to some shareholders. But the "fairness" of a transaction submitted for shareholder vote is ultimately an issue in any suit under the *Borak - Mills* line of cases because it is directly relevant to determining the available remedy. The fact was expressly recognized by this Court in *Mills*:

In devising retrospective relief for violation of the proxy rules, the federal courts should consider the same factors that would govern the relief granted for any similar illegality or fraud. One important factor may be the fairness of the terms of the merger.

* * *

Where the defect in the proxy solicitation relates to the specific terms of the merger, the district court might appropriately order an accounting to ensure that the shareholders receive the value that was represented as coming to them. . . . *If commingling of the assets and operations of the merged companies makes it impossible to establish direct injury from the merger, relief might be predicated on a determination of the fairness of the terms of the merger at the time it was approved.* 396 U.S. at 386, 389 (emphasis added)

Thus, this Court has recognized that the ultimate fairness to some or all of the shareholders of the trans-

action which is the subject of the proxy materials is directly pertinent to the remedy phase of the case. Consequently, fairness is properly the subject of allegations in the complaint and does not transform any challenge to the misleading character of the proxy materials used by a financial institution from a securities law suit into a challenge to a Board order. For as this Court held in *Bell v. Hood*, 327 U.S. 678, 681-682 (1946):

"The party who brings a suit is master to decide what law he will rely upon and . . . does determine whether he will bring a 'suit arising under' the . . . [Constitution or laws] of the United States by his declaration or bill." [W]here the complaint, as here, is so drawn as to seek recovery directly under the Constitution or laws of the United States, the federal court . . . must entertain the suit . . . For it is well settled that the failure to state a proper cause of action calls for a judgment on the merits and not for dismissal for want of jurisdiction.

If respondents' contentions (and the decisions below) were correct, any *Borak - Mills* proxy suit would be barred where a supervised or reviewed transaction is involved.

B. The supposed right of action under the Bank Board's regulations is an illusory remedy.

The second argument advanced by respondents to avoid the clear worthiness of the petition is that the Court of Appeals in some fashion recognized a cause of action under the counterpart Bank Board regulations, a cause of action which the petitioners somehow did not pursue. But the position advanced by the Government and Prudential, i.e., that the Court of Appeals acknowledged that petitioners may pursue an action under the counterpart regulations, will not withstand the most perfunctory analysis for at least two basic reasons.

First, it is settled law that the court should grant relief on any viable legal theory supported by the allegations of the complaint, even though not specifically alleged. *E.g., Conley v. Gibson*, 355 U.S. 41 (1957). Additionally, the securities laws have been consistently read by this Court as in *pari materia*. *SEC v. National Securities, Inc.*, 393 U.S. 453 (1969); *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963). The consequence of both lines of authorities is that the action of the Court of Appeals may not be justified on the basis that the complaint referred only to Rule 10b-5 and not to the Bank Board's counterpart regulations, for both respondents acknowledge that the complaint did factually allege that the proxy statement was defective*. Moreover, the Court of Appeals did not remand these cases for a factual determination of whether they presented claims under the counterpart regulations.

Second, a necessary corollary to the foregoing proposition is that petitioners may not pursue a new action based upon the counterpart regulations, as both respondents suggest, because of the bar of *res judicata*. Under that doctrine a previous judgment "is an absolute bar in another action . . . 'not only in respect of every matter which was actually offered and received to sustain the demand or to make out a defense, but also as to every ground of recovery or defense which might have been presented.'" 1B MOORES FEDERAL PRACTICE ¶0.410[2] at 1163, citing *Mendez v. Bowie*, 118 F.2d 435, 440, cert. denied, 314 U.S. 639 (1941). *Accord, Fox v. Connecticut Fire Insurance Co.*, 380 F.2d 360 (10th Cir. 1967).

*Another consequence of the in *pari materia* policy is that petitioners may seek redress under the general antifraud provisions of Rule 10b-5, as the complaint sought to do, rather than relying upon the specific antifraud provisions of the regulations, as respondents urge that they must. See Pet. at 6n 6; 2 BROMBERG, SECURITIES LAW § 6.5(3): "[t]he general provisions [i.e. Rule 10b-5] complement the specific ones [i.e. the proxy rules]."

C. *The petition presents for review an issue of broad applicability worthy of this Court's attention.*

The issue presented to this Court — whether shareholders in a conversion are entitled to a proxy statement making full disclosure — was squarely presented by the complaint and acknowledged in the opinion of the Court of Appeals. The certworthy quality of that issue cannot be argued away by suggesting that the Prudential plan was a unique "grandfather" conversion, or that Congress permitted the conversion on a "free stock" basis. As the petition stated, those factors in no way serve to distinguish this case from any other challenging proxy materials used in connection with a transaction reviewed by the banking authorities. (Pet. at 25-27)

The Brief of Prudential makes it clear that its position, and that of the Court of Appeals, is that the review procedure under the banking laws eliminated the right of shareholders to informed corporate suffrage guaranteed by the Securities Exchange Act of 1934. But it is petitioners' position that Congress, in providing for conversions and in enacting the Board order review procedures, did not reverse the *Borak - Mills* cases as they apply to banking institutions, nor did it usurp the right of shareholders to have the final word on matters submitted to their vote, without regard to the actions of the regulatory authorities. Every conversion, or for that matter every proposal of any national financial institution that requires shareholder action, must be accomplished pursuant to a proxy statement. It is the Court of Appeals' reading of the provisions governing this process which merits review. So long as these decisions stand, the requirements of disclosure in such instances will be significantly reduced and any challenge to disclosure made will be measured by the abuse of discretion standard rather

than the judicial standard that obtains in all other proxy contests.

The importance of these issues was recently discussed in Lee, *Conversion of Savings and Loan Associations from Mutual to Stock Form: Fairness Forgotten*, 33 Bus. L. 29 (November, 1977). Appropos the facts of this case, the author observed that "a small group of insiders can, by controlling the proxy mechanism, achieve a favorable vote for conversion quite easily" and that therefore "[o]nly by stating in the proxy, in plain terms, the effect of conversion on the ownership interests of the depositors, could a proxy be deemed valid under the [Bank Board's counterpart proxy] regulation." The author concludes that he has seen no proxy materials that meet this standard. This case, therefore, is a unique vehicle to define the disclosure standards which even now are occupying national attention, *before* irreparable injury is inflicted on the millions of investors in financial institutions.

CONCLUSION

For the foregoing reasons, and those stated in the petition, review should be granted.

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Respectfully submitted,

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